

## DETERMINING THE SIZE OF THRESHOLDS OF SMALL AND MEDIUM ENTERPRISES DEFINITION

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### **ABSTRACT**

*Small and Medium Enterprises (SMEs) play an important role in the economic development of the country. There has been a debate going on regarding the common thresholds in the definition of SMEs. Consensus has not reached yet. The common variables found across the world as regards to the definition of SMEs were employment, value of assets, annual turnover and paid up capital. Many countries across the world spend huge funds for determining appropriate size of SME definition thresholds therefore there was a need to conduct study. This was an exploratory study where secondary data sources of data were used. The study was qualitative due to its nature of the research problem. This study found that determinants of size of SME definition thresholds are variation in the state of development, population size, economic problems, strength of each business and industry, level of economic internationalization, government and non-government supported SME programs and institutional policy objectives.*

**Key Words:** SMEs, definition thresholds, determinants, policy objectives

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## 1 Introduction

Small and Medium Enterprises (SMEs) play an important role in the economic development of the country. There has been a debate going on regarding the appropriate size of thresholds in definition of SMEs across the world but consensus has not reached yet. The thresholds that varied across the world as regards to the definition of SMEs were employment, value of assets, annual turnover and paid up capital. Many countries across the world spend huge funds for determining appropriate size of SME definition thresholds therefore there was a need to conduct study. There is a need to conduct the study, which could help in determining the appropriate size of thresholds to be set for the purpose of the definition of SMEs. These common thresholds set for the purpose of SMEs would benefit to the national and international institutions. These institutions would be able decide easily as to whether or not to provide financial or management services support to the SMEs who really deserve help and such contribution could significantly be made towards the growth of their country. The debate is still open in the literature, discussing about which threshold is most appropriate and what should be the cap on the threshold. The paper explores the determinants of the appropriate size of the thresholds for the purpose of SMEs definition.

Some authors argue that it is difficult to take all the countries definitions on account while offering regional promotion of SMEs therefore it is important to have common definition. Secondly, there are some countries where even the SMEs definition is not available for example the World Bank provided SME definition of 132 countries out of which 12 countries definition of SMEs were not available. It was noted that governments and private financial institutions have given their respective definition therefore 26 countries around the world had more than one definition of SMEs (Kozak, 2007). Beside that, there are other institutions like statistical institutes, private banks, and governmental promotion agencies etc. who have developed their own definition according to their own requirements. There has been found a significant variation in the SME definition of all countries around the world. In this study it was found that around thirty three percent of SMEs around the world consider the definition of SMEs considering 250 headcounts of employment. The authors of this comprehensive work reviewed from various sources which include legal definitions taken from national law or abstract of the law; or the official document of the government. Algeria, Argentina, Armenia, Azerbaijan, Belarus, Belize, Bolivia, Burkina Faso, China, Ecuador; Ethiopia, Guyana, Hong Kong SAR, China, India, Indonesia, Korea Republic, Kuwait; Kyrgyz Republic; Malaysia; Mauritius; Nicaragua; Panama; Qatar; Singapore; Sri Lanka; Sudan, Thailand, United Arab Emirates and South Africa were excluded from the definition of SMEs on the grounds that either SME definition was available or they apply did not apply head count method for total number of employee. (Kushnir, Mirmulstein, & Ramalho, 2010).

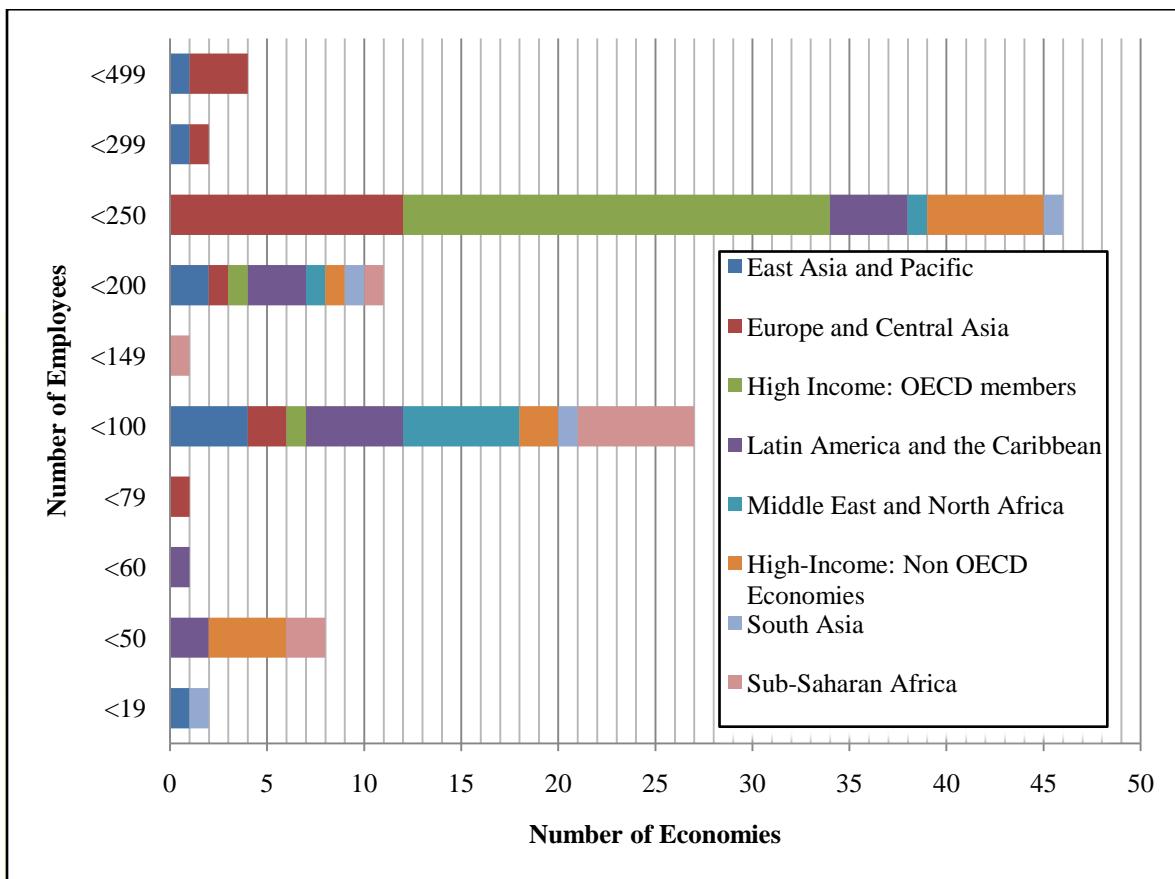
The unavailability of common definition in the country can have serious impact on the provision of funds by the donor agencies around the world. Similarly the same definition for all the countries around the world can also have an impact on the optimum use of benefits provided to the various countries around the world which are various stages of development (Gibson & Vaart, 2008). The distribution of the definitions of world economies shows that almost 44% of the world economies use the definition with head counts between 200 to 249 employees as shown in figure 1. Most of the high income OECD countries and Non OECD economies, Europe and Central Asian States follow the same definition of 250 employee head count.

Second most common thresholds found in the definition that was found around the world was that of the number of employees between 79 and 99. This comprised of 26% of the world economies. In this group, the most of the countries were from East Asia and Pacific, Latin America and Caribbean, Middle East and North Africa and sub Saharan Africa and few countries from Europe and Central Asia, High Income: OECD countries, High Income Non OECD economies and South Asia. The rest of the world economies were lying in various groups as shown in figure 2. Other criteria of definitions of SME throughout world like some countries have defined micro, small and medium enterprise separately. Further some countries have defined SMEs on some other variables like total assets, total turnover, capital and investment (Khrystyna, 2010).

The literature shows that research is in process where the common characteristics of definition of SMEs are discussed but no agreement made on the single definition of SME. The thresholds of definition of SMEs are set in the areas of:

1. Staff head counts should be up to certain required level
2. Assets measured in local currency as per latest balance sheet
3. Annual turnover measured in local currency
4. Paid up capital measured in terms of local currency

Exploratory studies are useful if the researcher lack the clear idea of determinants of SME definition (Cooper & Schindler, 2003). Data was collected through available secondary sources. The proposition was set for the future researchers to conduct the empirical study on this topic. The study was qualitative due to its nature of the research problem.

**Figure 1: Global Distribution of SMEs according to definition of head count of employees**

Source: MSMEs data of World Bank (Ayyagari, Beck, & Demirguc-Kunt, August 2003)

## 2 Determinants for SMEs thresholds

Some researchers argued that instead of giving one common definition for all economies there should be adjustable definition of SME. Determinants for the definition of SMEs thresholds are discussed below

### 2.1.1 Variation in the State of Development

Variation in the state of development is a determinant of thresholds of SME definition (European Union, 2003). Determination of the employment threshold varies with respect to national income of the country. High-income economies set the maximum number where as low income economies set the minimum number. Change in the national income brings change in the employment opportunities created in the country. High-income economies need to set high threshold so that SMEs are encouraged to hire more people and still they will qualify as an SMEs. The impact is verified at the global level where it was found that high income economies set the maximum number and vise versa for the low income economies.

**Table 1: Thresholds of Employment across the worlds**

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Indexed & Listed at: Ulrich's Periodicals Directory ©, U.S.A., Open J-Gage as well as in Cabell's Directories of Publishing Opportunities, U.S.A.

Economies	Employment Level Threshold Up to 99	Employment Level Threshold between 100-249	Employment Level Threshold 250 and above
High Income Economies	13.5%	73%	13.5%
Upper Middle Income Economies	30%	70%	0%
Lower Middle Income Economies	61.5%	38.5%	0%
Low Income Economies	68.4%	26.3%	5.3%

**Source:** Modified from MSME: A collection of Published Data (Kozak, Micro, Small, and Medium Enterprises: A Collection of Published Data, 2007)

#### 2.1.2 Strength of each Business and Industry

If the businesses or the industries are growing stronger in any economy, it would have major impact on the employment. Since the business or industry is well off therefore setting a small thresholds would not include many firms benefiting out of their status. This will again encourage to small business investors to grow industry further stronger (Kozak, 2007).

#### 2.1.3 Economic Problems

There is lot of variation among the problems faced by any economy. Problems like terrorism, floods, earthquakes, financial crisis, unemployment has the significant economic implications and ultimately it is going to affect the growth of SMEs (European Union, 2003). Thus if these problems prevail definition of the SMEs would be modified to further encourage SMEs. Thus in this scenario maximum firms should qualify as an SMEs where the support should be provided by these national or international agencies. Therefore, thresholds should be relaxed to provide the benefits to the maximum people to stabilize the economy again.

#### 2.1.4 Population Size

The variation in the population of the country may also lead to change in the definition of SME (European Union, 2003). The highly populated countries may set the maximum thresholds specially of employment and vice versa. However, density of the population would further increase the thresholds of SMEs. For example, countries like China (Xiangfeng), India (The Gazette of India, 2006), Pakistan (SME Policy 2007, 2007) etc. have set the maximum number of employees.

#### 2.1.5 Nature of Industry

Nature of industry also matters while setting the threshold for any economy (European Union, 2003). The nature of industry means what type of concern it is. Like for example: manufacturing, non-manufacturing, agricultural, mining related, retail or services provider firm. More labor is required for mining and manufacturing concern firm. While for retail or services sector few employees would be sufficient. Therefore, there should be separate threshold for each industry as in case of Pakistan (Khan, Hasnain, Achakzai, & Ahmed, 2003) (SME Bank), USA (Small Business Administration, 2007), South Africa (Wayne Wittig), Malaysia (SME International, 2005), Canada (Teraoui, Kaddour, Chichti, & Rejeb, 2011) (Industry Canada, 2011), China (Xiangfeng), Bangladesh (Alam & Ullah, 2006), India (The Gazette of India, 2006).

#### Government and Non-government Support Programs

Every firm would like to qualify as SMEs because of the SMEs incentives supportive programs. It is important that there should be no lobbying or the influence of the large businesses in setting up of the thresholds of SMEs. There are many programs offered by the international institutions for encouraging SMEs. Like for example finance programs of IFC-World Bank. IFC had portfolio of \$8.3 billion in fiscal year 2010. It had kept \$1.5 million for the purpose of loans to SMEs. It further encourages building capacity of financial intermediaries, seminars on best SME banking practices, investments and technical assistance to support financial intermediaries. The regional SMEs support programs of World Bank like SWITCH Asia program, competitiveness and innovation framework program 2007-2013, support program for entrepreneurship and enterprise competitiveness, etc. are also SMEs supporting programs (INSMEs, 2012). Canada Foundation, EUREKA-an intergovernmental network, JEREMIE-the Joint European Resources for Micro to Medium Enterprises, KFW Bankengruppe, European Union structural funds do provide national public and private funding schemes. The objectives of these schemes is to provide skills and expertise, research and development facilities, joint research projects across the world (Bankengruppe, KFW). This support of the international institutions would also reduce the income disparity, wealth disparity and opportunities disparity (European Union, 2003).

#### 2.1.6 Level of Economic Internationalization

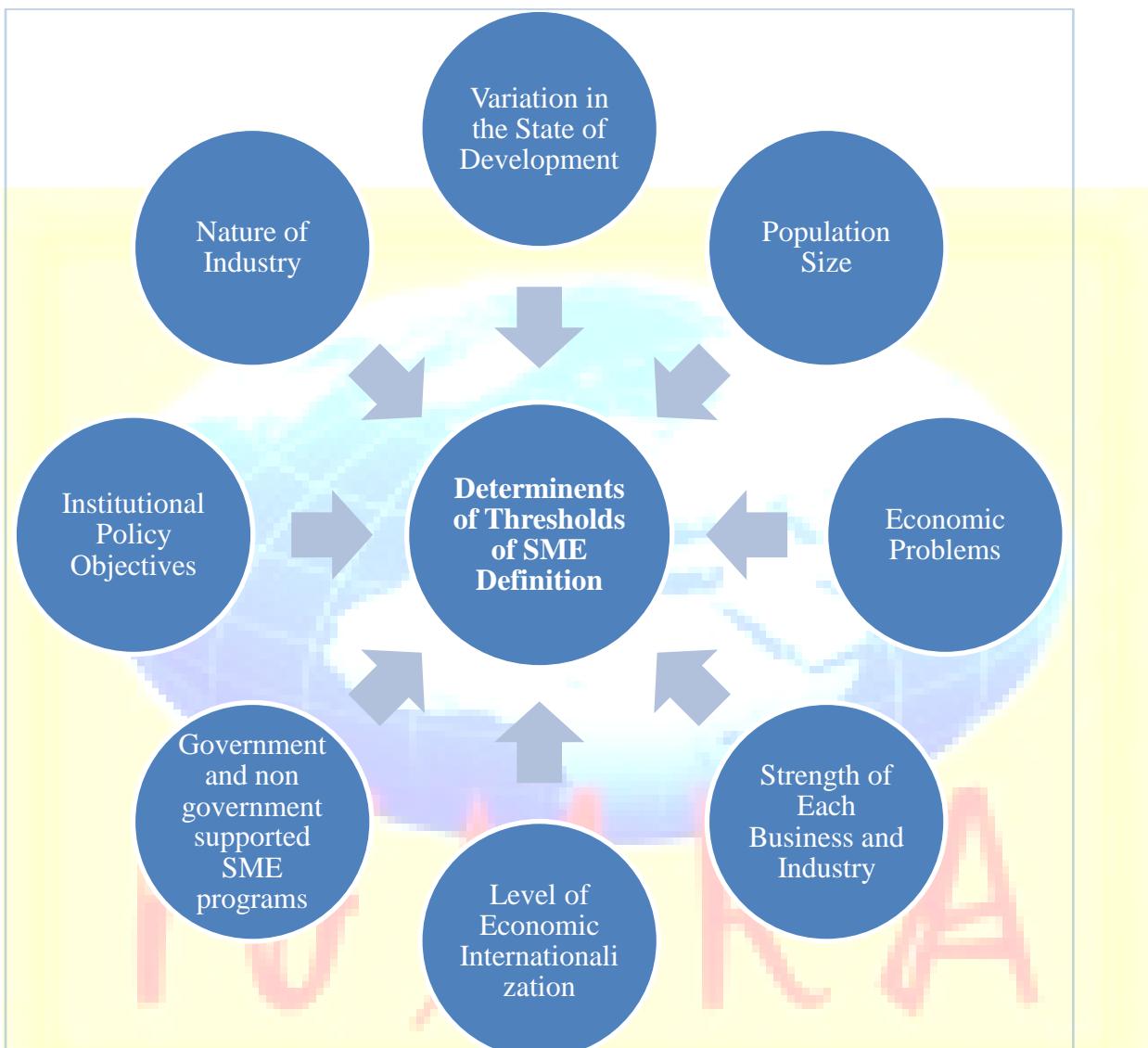
Economic internationalization also affects the thresholds of SME definition. Economic internationalization leads to the provision of cheaper goods from international market. In order to encourage the local firms the definition of SMEs is relaxed so that maximum economic activity may occur (European Union, 2003).

#### 2.1.7 Institutional Policy Objectives

Institution launching any SMEs supportive programs has certain objectives. It tries to achieve the specific level of employment, growth, income and equality. Accordingly, institution sets the

thresholds for the SMEs definition to include specific quantity of the firms. Thus, the institutions give their own SME definition by rejecting existing or current definition.

**Figure 2: Determinants of Definition of SME Definition**



### 3 Conclusion

This study found that determinants of size of SME definition thresholds are variation in the state of development, population size, economic problems, strength of each business and industry, level of economic internationalization, government and non-government supported SME programs, institutional policy objectives. The empirical work study can be conducted on this topic as it is very important topic considering the importance of SMEs across the world. For the policy implication purpose this study

would help the policy makers to formulate the definition of SMEs which has been the point of initiating any support plan for the purpose of SMEs.

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